United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

ORIGINAL

74-1750

BP/S

United States Court of Appeals

For the Second Circuit.

SECURITIES AND EXCHANGE COMMISSION,
Plaintiff-Appellee,

-against-

NORTH AMERICAN RESEARCH AND DEVELOPMENT CORP., EDWARD WHITE and ALFRED BLUMBERG,
Defendants-Appellants

REPLY BRIEF FOR APPELLANTS WHITE AND NORTH AMERICAN RESEARCH AND DEVELOPMENT CORP.

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UNITED STATES COURT OF APPEALS

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Docket Nos. 74-1750
74-1831

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Plaintiff-Appellee

-against-

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Defendants-Appellants

PRELIMINARY STATEMENT

Symptomatic of the Government's lack of understanding of our argument--or its inability to respond to it--is the statement (Br., page 17, 18) that we are attacking the validity of Rule 65 (a) (2).

Far from challenging Rule 65, we are relying upon a written motion made by White's then lawyer, six weeks before the hearing and while White's defense was being prepared, to consolidate the preliminary injunction hearing with the trial on the merits.

Consolidation is, of course, the essence of Rule 65 and White's lawyer was trying to use the Rule as it was intended to be used, to avoid having to prepare twice, to know, in advance, that he was preparing for a plenary hearing, for his client's due process-sanctioned "day in Court".

That Judge Ryan denied the motion only points up the fact that the preliminary injunction hearing was only that, and the fact that everybody expected that there would be a trial on the merits later, and speedily, is clear beyond cavil.

Preparing for a hearing where the only requirement that the Commission had was to put in a prima facie case is one thing--preparing for a "trial on the merits", is a totally different thing. White's lawyer prepared for a hearing.

What we are challenging is not Rule 65 but its application to the facts of our case.

What are the facts of our case? "Counterstating" the "facts"--as the Government's brief does for 12 pages (page 5-16)--simply will not do.

The "counterstated facts" are a repetition by Judge Weinfeld of the "facts" found by Judge Mansfield after the preliminary injunction hearing, and the "facts" repeated by

Judge Medina for this Court in affirming Judge Mansfield. But that is precisely what we are objecting to. Judge Mansfield--based partially at least on concededly inadmissible (on a trial) evidence--found only enough for a prima facie case. The only thing which this Court's affirmance of Judge Mansfield accomplished was to affirm that a prima facie case had been made out, enough to justify a temporary injunction. Indeed, this Court had no greater function or power. Then Judge Weinfeld, still based on the same evidence which resulted in Judge Mansfield's finding of a prima facie case, found enough to justify not only a prima facie case but a case on the merits, and not only for a temporary injunction but for a permanent injunction.

This "counterstatement" of facts ignores the defendant White's motion to consolidate the hearing with the trial, ignores Judge Ryan's order denying consolidation, ignores the two-year delay in moving the case to trial, ignores the motion for summary judgment which the Commission made in order to avoid a trial, ignores Judge Motley's denial of the motion as against White, ignores our motion for a trial de novo which Judge Weinfeld denied, ignores the almost six-year delay between the hearing and the trial, which took place before a different Judge.

But these are the facts of our case, and that is the whole point of this appeal.

Our position is that this concatenation of facts amounted to a denial to the defendants of elementary due process.

CRITIQUE OF COMMISSION'S BRIEF

Not only does the Commission's counterstatement of facts show a lack of understanding of our argument but the cases which they cite fall into the same limbo because they do not grapple with what we are talking about.

For example, in arguing that evidence adduced at a preliminary injunction hearing becomes "part of the record on the trial"--which, of course, nobody disputes--they cite SECURITIES AND EXCHANGE COMMISSION v. MANOR NURSING CENTERS, INC., 458 F.2d 1082, 1088-1089, n.2 (C.A. 2, 1972).

This footnote reads as follows:

> "When the instant complaint was filed, the SEC sought and obtained a temporary restraining order pending the hearing and determination of the SEC's motion for a preliminary injunction. The hearing on the preliminary injunction motion began on August 19, 1971 and was concluded on August 20.

> After this hearing, the court reconsidered and granted the SEC's motion to advance the date of trial and to consolidate it with the hearing on the preliminary injunction motion. The trial commenced on September 30, 1971. Thus, the trial record includes some evidence which actually was presented at the hearing on the preliminary injunction motion. Rule 65 (a) (2), Fed. R. Civ. P."

Trying to compare a case where there was a consolidation of a preliminary hearing which took place on August 19, 1971, and August 20, 1971, with a trial which took place on September 30, 1971, with the same Judge, with our case, where there was a six-year separation between the temporary injunction hearing and the trial, and no consolidation, and a different Judge, staggers the imagination.

The trouble with the Commission's brief is that it accepts the letter of Rule 65 and obliterates the meaning and spirit of the Rule. The brief goes along on the theory that this was a routine case involving a preliminary hearing and a trial and that Rule 65 says that testimony taken at a preliminary injunction hearing becomes part of the record of a trial on the merits, and that that is all that happened here. Of course, passing reference is made to the fact that Judge Weinfeld made an order stating that the Commission would be allowed to proceed on the basis of the preliminary hearing

testimony; and, since we were told that, what are we complaining about? But nowhere in the brief can be found any justification, by citation of law or argument, that Judge Weinfeld was right.

No case we have been able to find remotely approaches considering the question of the use of preliminary hearing testimony at a trial almost six years later. Would Judge Weinfeld's reading of Rule 65 be correct if this trial took place 16 years later? Or 26 years later? There is nothing in Judge Weinfeld's opinion or in the Commission's brief which even considers this question.

Surely the Government had the burden of proof--by competent and admissible evidence--preliminarily to make out a prima facie case (which was enough for a temporary injunction) but ultimately a case sufficient to justify the granting of a permanent injunction. But the proof here was identical for both. And we are now asked to assume that that proof existed despite Judge Mansfield's finding that only a prima facie case had been established, and despite Judge Motley's comment, in denying summary judgment, that because only a prima facie case had been proved, the defendants were entitled to a day in Court.

Judge Weinfeld's comment in a footnote to his decision, "The defense at this trial was, of course, free to call any witness or offer any additional evidence, but failed to do so", simply sharpens what we consider to be a lack of understanding of the meaning of Rule 65.

The burden of proof was on the Government, not upon us.

Since Commission's counsel had told Judge Mansfield in the remand hearing that he was going to produce other witnesses at the trial, and since we, of course, had no way of knowing who they were going to be or what they were going to testify to, and since we could not know what the Commission specifically was going to charge us with, there would have been no way for us to have produced witnesses--even if they were available--to counter the Government's case.

Is it not strange that with the thousands of Securities Commission cases which are in the books, and the hundreds which have been decided since Rule 65 was amended, the Commission has been unable to find even one case which resembles ours on the facts?

And, since this seems to be a case of first impression, this Court should write an opinion strongly condemning what happened here.

Finding no case in point, the Commission is reduced to arguing by analogy, and the analogy is that it is not unusual to have previously-taken evidence used at a later trial--as if anyone was saying that it was--and they cite in this connection four cases, namely WALKER v. LOOP FISH AND OYSTER CO., 211 F.2d 777, 780 (C.A. 5, 1954), INSUL-WOOD INSULATION CORP. v. HOME INSULATORS INC., 176 F.2d 502, 504 (C.A. 10, 1949), HERTZ v. GRAHAM, 23 F.R.D. 17 (S.D.N.Y., 1958), and IKERD v. LAPWORTH, 435 F.2d 197 (C.A. 7, 1970).

The first case, WALKER, involved a group of negligence cases flowing from the same accident, some non-jury and one jury.

The Judge heard the jury case first. Upon appeal, objection was made that the evidence should have been repeated in the non-jury cases. The Court of Appeals of the Fifth Circuit, rejecting this argument, said:

> "The case in which a jury trial was demanded was tried first. In that case the issues of negligence and contributory negligence were fully developed by the evidence. Before commencing the jury case, the district judge notified counsel in these cases that in order to avoid needless repetition, all evidence on the question of negligence taken in the jury case would be "incorporated" in the non-jury cases, but that the parties to the non-jury cases could introduce in those cases any additional evidence they

> desired on the question of negligence. The trial court further notified plaintiffs in the non-jury cases (appellants here) that they could fully participate in the jury case, which was done."
>
> . . . . .
>
> "The same judge tried both the jury and the non-jury cases. It would have been a work of supererogation, and a needless waste of time, for the trial judge to have again heard in the non-jury cases the lengthy evidence on the question of negligence which he had just heard eleven days before, in the jury case."

This case, of course, strengthens our argument. Here, again, we have an eleven-day spread instead of a six-year spread, we have the same Judge and not a different Judge, and we have notice before the first case, that the evidence would be "incorporated" into the later cases.

The other three cases, INSUL, HERTZ, and IKERD, are cited in support of the proposition that even depositions taken on an earlier occasion may be used at a later trial. But these cases are totally irrelevant to our point. Each of these decisions which, it is true, did permit the use of a deposition, stated that the deposition would be admissible if it complied with the requirements of Rule 26 (d) (3).

Rule 26 (d) (3), of course, has to do with using a deposition when the deponent has died, or is more than 100 miles from the place of trial, or for some other reason is not able to testify.

In our case, of course, this was not the fact. How many of the other witnesses were available on the day of the trial, June 27, 1973, I do not know, but Edward C. Jaegerman, the Government's principal witness at the preliminary hearing, was in Court throughout this trial under my subpoena. I had subpoenaed him to use him, even as a hostile witness, which he undoubtedly was, if the Commission put on any other witnesses, as they had said they were going to do. Since they did not, I felt no obligation to call him and I did not call him.

Rather than use his testimony in the preliminary hearing, which had been subject to cross-examination six years ago, the Commission could have, and should have, called him at the trial. It was their responsibility, not ours.

Even the case of RICHMOND v. BROOKS, 227 F.2d 490 (C.A. 2, 1955), cited by the Commission for the proposition that the plaintiff's entire case can consist of a deposition is also irrelevant because in that case, although the plaintiff did rely only upon a deposition, she lived in California and the trial was in New York and the Court made it clear in its decision that a person who could not afford to make a trip from California to New Your should not be prejudiced for not being personally in Court. What that has to do with our case is beyond my understanding.

And so we come to the due process cases.

First, they complain that we are "trivializing" our due process argument and they cite MARKET STREET RY v. RAILROAD COMMISSION, 324 U.S. 548, 562 (1945).

This was a railroad rate case in which the railroad claimed a due process violation because the Commission went outside the hearing record and used the railroad's own monthly income figures, whose accuracy the railroad did not challenge.

This objection certainly was trivial, as the Supreme Court noted in disregarding it. Again, we do not understand the sense of this citation. What we are complaining about is that we were totally deprived of a trial by Judge Weinfeld's misreading of Rule 65, and this is certainly not "trivializing" the demands of due process.

The next case they cite is BODDIE v. CONNECTICUT, 401 U.S. 371, 378 (1971) but only to cite from it a quote from ARMSTRONG v. MANZO, 380 U.S. 545 (1965).

BODDIE was the case in which the Supreme Court struck down as a denial of due process a State law which required the payment of a filing fee, even in a divorce case, thus making it impossible for an indigent person to obtain a divorce because he could not pay the filing fee.

ARMSTRONG was an adoption case in which the Court held that it was a denial of due process not to have permitted the natural father of an adopted child to have the right to a hearing in which he could cross-examine the petitioners, his former wife and her new husband. But this is precisely what we are complaining about.

They cite the case, however,--in a truncated quotation--to argue that since we had an opportunity to cross-examine adverse witnesses if not at the hearing, certainly at the trial, because Judge Weinfeld had ruled, in denying our motion for a de novo trial, that we could call witnesses, we were not deprived of due process.

The full quotation reads as follows:

> "A fundamental requirement of due process is "the opportunity to be heard". Grannis v. Ordean, 234 U.S. 385, 394 34 S.Ct. 779, 783. It is an opportunity which must be granted at a meaningful time and in a meaningful manner".

The only "meaningful time" at which we could have been heard was at the trial and the only "meaningful manner" was in a de novo trial.

What the Court also said in ARMSTRONG is the following:

> "Many controversies have raged about the cryptic and abstract words of the Due Process Clause but there can be no

> doubt that at a minimum, they require that deprivation of life, liberty or property by adjudication be preceded by notice and opportunity for hearing appropriate to the nature of the case. Mullane v. Central Hanover Bank and Trust Co., 339 U.S. 306. (Emphasis ours)

What was "appropriate to the nature" of our case would have been a de novo trial.

See also, MILLIKEN v. MEYER, 311 U.S. 457, also cited by the Court in ARMSTRONG.

Next, the Commission cites NEES v. SECURITIES AND EXCHANGE COMMISSION, 414 F.2d 211 (C.A. 9, 1969), and HANSEN v. SECURITIES AND EXCHANGE COMMISSION, 396 F.2d 694 (C.A. D.C.), certiorari denied 393 U.S. 847 (1968).

The Commission cites NEES for the proposition that due process was not violated "so long as the appellants had been afforded an opportunity for cross-examination at the time of the trial".

In this case the defendant defaulted on a hearing in August, 1965, and after a motion to open his default had been granted, he appeared in February, 1966. Before the same Judge two of the petitioner's former customers, after confirming their testimony at the first hearing, were extensively cross-examined by the petitioner.

He complained on appeal that he was entitled to a de novo hearing.

The petitioner's argument was that although he had been given the right to cross-examine the two witnesses, he was nevertheless injured because he had not been present when they testified originally.

The Court rejected this as "a specious argument".

How this helps the Commission is beyond my understanding, or, for that matter, HANSON, which was cited by the Court in NEES.

There, objection was made against the use of the "testimonial record of a prior proceeding". The Court said, "Since the witnesses who testified in the prior proceeding were made available to petitioner for cross-examination, we find no error".

If the witnesses in the preliminary hearing had been made available to us at the trial before Judge Weinfeld, we would have no cause to complain.

We come next to a concession in the Commission's brief (page 21-23) that they "have no disagreement with" the cases which we cite in support of our argument that, absent notice in the preliminary hearing that a trial on the merits is going to take place, no permanent injunction may issue. But, they argue, that is not this case because Judge Weinfeld, in denying our request for a de novo trial, told us that he was going to rely on the preliminary hearing testimony and that this was sufficient notice.

But that is the whole point of this appeal. Due process requires notice at the time of the preliminary hearing, not six years later.

The Commission also concedes that the granting of permanent relief creates a "heavier burden" on the Commission than the granting of preliminary relief; but, they go on, it does not follow from this that "the evidence presented at the preliminary hearing was <u>necessarily</u> insufficient to meet the higher burden of proof." (emphasis ours). And, they conclude, it must have been sufficient because Judge Weinfeld told us that he was going to rely on admissible evidence, and that "it is presumed that the Court relied only on proper evidence in reaching its conclusion". (Br., page 23).

And, in this connection, they cite two cases, UNITED STATES v. 6.78 ACRES OF LAND IN THE VILLAGE OF GARDEN CITY, NASSAU COUNTY, N. Y., 147 F.2d 351 (C.A. 2, 1945); and BUILDERS STEEL CO. v. COMMISSIONER OF INTERNAL REVENUE, 179 F.2d 377, 379, (C.A. 8, 1950).

COMMISSION v. 6.78 ACRES is cited as authority for the fact that in a trial without a jury it will be presumed, absent a clear showing to the contrary, that the trial court relied only on proper evidence in reaching its conclusion. That may be valid in a case where the Judge who heard the testimony and observed the demeanor of the witnesses made the finding. But in our case Judge Weinfeld was not the Judge who heard the testimony and who observed the demeanor of the witnesses and who, it will be presumed, excluded from his mind all of the inadmissible testimony. Judge Weinfeld read a cold record six years old and there is no way of knowing what he excluded from his mind.

In BUILDERS STEEL, the Court of Appeals in the Eighth Circuit said that there could be a reversal if it "affirmatively appears that the Court relied on incompetent evidence".

As we have already said, the way this case went, we have no way of knowing--and, therefore, showing--what Judge Weinfeld relied on. But we do know--and this is admitted--that inadmissible evidence was received by Judge Mansfield, and we do know that the total evidence at the preliminary hearing was, in the opinion of the Commission's counsel, insufficient for a permanent injunction. That is what he told Judge Mansfield on the remand.

And in BUILDERS STEEL, although the Court said that an appellate court would not reverse "unless all of the competent evidence is insufficient to support the judgment", they did reverse because the Tax Court erroneously excluded competent and material evidence.

Finally, it is not without legal significance that this case originally had 43 defendants and now only 2 are left, nor that injunctions were granted by consent against some of the other defendants and by default against others. We are here--six years later--asking for one of the most fundamental rights of an American citizen, namely the right to a trial, the right to a day in Court to defend himself. Judge Weinfeld recognized this when he instructed Commission's counsel--after the trial--to write a brief "pinpointing" in

the record the actions of the two remaining defendants, White and Blumberg, which justified an injunction. This was never done so that we never had the opportunity to respond to the specific charges against us.

In conclusion on this point, the following Kafka-esque comment on page 20 of the Commission's brief amply demonstrates the chasm which separates our view of this case from theirs:

> "In any event, the appellants do not show in what manner, if any, they were prejudiced by the use of the earlier testimony. One would assume, to the contrary, that the procedure followed was greatly to their advantage."

THE BREADTH OF THE INJUNCTION

We do not propose to burden this Court with an analysis of the cases cited in the Commission's second point, that the breadth of the injunction was justified. We trust that the Court will never reach this point, but if it does, we rely on what we have already said.

CONCLUSION

The judgment should be reversed and the case remanded with instructions for a plenary trial.

Respectfully submitted

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ROBERT BAILEY, being duly sworn, deposes and says, that deponent is not a party to the action, is over 18 years of age and resides at 286 Richmond Avenue, Staten Island, N.Y. 10302. That on the 13 day of November , 1974 deponent served the within brief upon WILLIAM D. MORAN and GLASS & GREENBERG

attorney(s) for SEC and defs. No. American Research and K. Ralph Bowman

in this action, at 26 Federal Plaza, NYC 1007 and 540 Madison Ave., NYC

the address designated by said attorney(s) for that purpose by depositing 3 true copies of same enclosed in a postpaid properly addressed wrapper, in an official depository under the exclusive care and custody of the United States post office department within the State of New York.

Robert Bailey
ROBERT BAILEY

Sworn to before me, this
13 day of November, 1974

William Bailey
WILLIAM BAILEY
Notary Public, State of New York
No. 43-0132945
Qualified in Richmond County
Commission Expires March 30, 1976